BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2002-4-G - ORDER NO. 2002-722

OCTOBER 9, 2002

IN RE: Annual Review of the Purchased Gas Adjustment and the Gas Purchasing Policies of Piedmont Natural Gas Company.	)))	ORDER RULING ON GAS COSTS AND GAS PURCHASING POLICIES

INTRODUCTION

This matter comes before the Public Service Commission of South Carolina ("Commission") on its annual review of the Purchased Gas Adjustment ("PGA") and gas purchasing practices of Piedmont Natural Gas Company ("Piedmont"). This review is being made pursuant to the provisions and requirements of Order No. 88-294, dated April 6, 1988.

By letter, the Commission's Executive Director instructed Piedmont to publish a prepared Notice in a newspaper of general circulation in the areas affected by the proceeding. The Notice indicated the nature of the annual review and advised all interested parties of the manner and time in which to file appropriate pleadings for participation in the proceedings. Piedmont was also instructed to notify directly all of its customers by furnishing a copy of the Notice to each customer. Piedmont submitted publishing affidavits and a certification indicating that it had complied with instructions of the Executive Director. The Consumer Advocate for the State of South Carolina ("Consumer Advocate") intervened in the proceedings.

A hearing was held on this matter on July 18, 2002, at 10:30 AM in the Commission's hearing room, with the Honorable Mignon Clyburn, Chairman, presiding. Piedmont was represented by Kerry B. McTigue, Esquire and Jerry W. Amos, Esquire. Piedmont presented the direct testimony of Ann H. Boggs and the direct testimony of Keith P. Maust. The Consumer Advocate was represented by Hana Pokorna-Williamson, Esquire. The Consumer Advocate did not present any witnesses. The Commission Staff ("Staff") was represented by Florence P. Belser, Deputy General Counsel. The Staff presented the testimony of Roy H. Barnette and Brent L. Sires.

SUMMARY OF EVIDENCE

Piedmont witness Keith P. Maust presented testimony describing Piedmont's gas purchasing policies. Witness Maust described Piedmont as a local distribution gas company primarily engaged in the purchase, distribution, and sale of natural gas to more than 704,000 customers in the Piedmont region of South Carolina and North Carolina and the metropolitan area of Nashville, Tennessee. In South Carolina, Piedmont serves approximately 122,000 customers, and Piedmont delivered 24,673,779 dekatherms to Piedmont's customers in South Carolina during the twelve month period ending March 31, 2002.

Witness Maust explained that Piedmont provides service to two distinct markets, one being the firm market principally comprised of residential, small commercial, and small industrial customers, and the other being the interruptible market comprised principally of large commercial and industrial customers. With regard to the firm market, Piedmont competes with electricity for the attachment of firm customers. However, witness Maust explained that once a firm customer is attached to the Piedmont system these customers have no readily available alternative source of energy and depend on natural gas for their basic space heating or utility needs. For the twelve month period ending March 31, 2002, Piedmont delivered approximately 14,400,000 dekatherms, or 58% of its deliveries, to the firm market in South Carolina.

In the interruptible market, Piedmont competes on a month to month and day to day basis with alternative sources of energy, primarily fuel oil or propane and, to a lesser extent, coal or wood. The larger commercial and industrial customers in the interruptible market will buy alternate fuels when those fuels are less expensive than gas. During the twelve month period ending March 31, 2002, approximately 10,300,000 dekatherms, or 42%, of Piedmont's South Carolina deliveries were to the interruptible market.

According to witness Maust, Piedmont has and continues to maintain a "best cost" gas purchasing policy, which consists of five main components: the price of gas, the security of the gas supply, the flexibility of the gas supply, gas deliverability, and supplier relations. Maust described each of the five components[1] of Piedmont's "best

[1] Witness Maust provided the following descriptions for the five components of Piedmont's best cost" gas purchasing policy.
(a) The "price of gas" refers to the delivered cost of gas to Piedmont's city gate. In order to properly judge prices at a comparable transaction point, Piedmont evaluates prices at the pipeline city gate points of delivery into Piedmont's distribution facilities.
(b) "Security of gas supply" refers to the assurances that the supply of gas will be available when needed. While it is obviously important to maintain a high level of supply security for Piedmont's firm customers who have no alternate fuel capability, security of gas supply is less important for interruptible customers who have access to alternate fuels. The security of gas is interrelated with the price of gas because fixed reservation fees are generally required in addition to the commodity cost of gas in order to reserve firm gas supplies under contract. Additionally, the geographic source of supply, the nature of the supplier's portfolio of gas supplies, and negotiated contract terms must be considered when evaluating the level of supply security.
(c) "Flexibility of gas supply" refers to Piedmont's ability to adjust the volume of a particular gas supply as operating and market conditions change from time to time. For example, firm heat sensitive customers will vary their consumption depending on the weather conditions, and interruptible customers will vary

cost" gas purchasing policy and the steps taken during the review period to comply with that policy.

The five main components of Piedmont's gas purchasing policy are interrelated and the relative importance of each component must be weighed when developing an overall gas supply portfolio to meet the needs of Piedmont's customers. Maust explained that Piedmont attempts to secure and maintain a supply portfolio that is in balance with the requirements of its sales markets. Because Piedmont's firm sales market must have a secure and reliable gas supply, Maust testified that Piedmont meets the needs of its firm sales market with long-term firm supply and transportation contracts, supplemented by storage and peaking services. Further, temperature sensitivity of the firm market necessitates that flexibility of supply and storage be provided. Maust noted that firm supply contracts demand a premium payment, typically in the form of fixed reservation fees, and firm supply contracts with flexibility of swing service entitlements command a higher price than baseload arrangements. Regarding the interruptible market, witness Maust testified that the interruptible market is more price sensitive and requires less supply security. Piedmont supplies its interruptible market with off-peak firm gas supply

their level of purchase depending on the price of alternate fuels and the demand for product in their industry. Thus, Piedmont must arrange a portfolio of gas supplies and storage service flexible enough to meet the daily and monthly "swings" in the market place.

(d) "Gas deliverability" refers to the ability to obtain Piedmont's gas supplies at the city gate through reliable transportation and storage capacity arrangements. Transportation arrangements can involve supply area gathering services, intrastate transportation, interstate lateral line and pooling services, multiple interstate pipeline transportation and storage arrangements, and balancing and peaking services. The marketplace for pipeline capacity is dynamic with supply and demand determining availability. Piedmont must secure and maintain transportation and storage capacity rights to ensure deliverability of its gas supplies to meet the peak day, seasonal, and annual needs of the customers, and pipeline capacity contracts require the payment of fixed demand charges to reserve firm transportation or storage entitlement.

(e) "Supplier relations" refers to the dependability, integrity, and flexibility of a particular gas supplier. Piedmont contracts with gas suppliers which have a reputation of honoring their contractual commitments and have proven themselves as reliable suppliers. Further, Piedmont avoids suppliers which have a reputation of defaulting on contract obligations or which unilaterally interrupt contracts to their advantage.

and transportation services when the core market demand declines as well as through the purchase of gas supplies in the spot market. Maust stated that Piedmont is satisfied that the policies and procedures presently in place are prudent and that the policies and procedures have produced adequate amounts of reasonably priced gas for Piedmont's customers.

Maust testified that Piedmont did not make any changes in its "best cost" gas purchasing policies or practices during the year, but Maust outlined additional steps taken by Piedmont to manage its gas costs, consistent with its overall "best cost" gas purchasing policy. The additional steps outlined by Maust of Piedmont managing its gas costs consistent with its "best cost" gas purchasing policy include: (1) that Piedmont has actively participated in proceedings before the FERC and other regulatory agencies that could reasonably be expected to affect Piedmont's rates and services; (2) that Piedmont has actively renegotiated and restructured eligible supply and capacity contracts to take advantage of market opportunities; (3) that Piedmont has utilized the flexibility within its supply and capacity contracts to purchase and dispatch gas, and release capacity, in the most cost effective manner, resulting in South Carolina capacity release increases in credits of $1,825,051 during the test period for a total capacity release credit of $3,641,042; (4) that Piedmont has actively promoted more efficient peak day use of natural gas and load growth from "year-round" markets in order to improve the Company's load factor and reduce average unit costs; and (5) that Piedmont has reviewed its gas supply activities with its internal Planning Committee in order for the gas supply department to receive input and direction on its performance and planning activities.

Witness Maust testified that Piedmont purchases gas supplies under a diverse portfolio of contractual arrangements with a number of reputable gas producers and marketers. In general under Piedmont's firm gas supply contracts, Piedmont pays negotiated reservation fees for the right to reserve and call on firm supply service up to a maximum daily contract quantity (nominated either on a monthly or daily basis), and market-based commodity prices tied to indices published in industry trade publications. Firm contracts range in term from one year (or less) to terms extending through October, 2004. Longer term contracts typically provide for periodic reservation fee renegotiations. Some of the contracts are for winter only (peaking or seasonal) service, and some provide for 365 day (annual) service. Firm gas supplies are purchased for reliability and security of service and are generally priced on a reservation fee basis according to the amount of nomination flexibility built into the contract, with daily swing service being more expensive than monthly baseload service. When existing supply contracts expire, requests for proposals are sent, as needed, to suppliers meeting Piedmont's "best cost" gas purchasing policy requirements. Firm supplies are then contracted from suppliers whose proposals best fulfill Piedmont's "best cost" gas purchasing policy.

Maust also described Piedmont's activities on the spot market. According to Maust, Piedmont purchases gas supplies in the spot market under contract terms of one month or less. These contracts provide for little or no supply security in that these contracts are interruptible and short term in nature. As a result, Piedmont relies on these contracts primarily for interruptible markets during offpeak periods when spot supplies are more abundant and for supplemental system balancing requirements. Due to the nature of the spot market, these supplies do not command reservation fees and are priced on a commodity basis, generally by reference to industry index or negotiated prices.

Company witness Ann H. Boggs testified regarding Piedmont's accounting relating to gas costs and gas inventories. Witness Boggs stated that current true-up procedures result in a properly stated cost of gas and that Piedmont's gas costs are properly recorded in compliance with Piedmont's Gas Cost Recovery Mechanism as approved by the Commission. Further, Boggs stated that the Deferred Account balance is properly stated at March 31, 2002.

Staff witness Roy H. Barnette presented testimony that the Commission's Audit Staff had reviewed the monthly filings made by Piedmont and the activity included in Piedmont's Deferred Cost of Gas Account No. 253.04 for the period April, 2001 through March, 2002. According to witness Barnette, Piedmont began the review period with a net under-collection of $5,061,057. Barnette proposed certain adjustments[2] to the monthly filings of Piedmont, with the net effect of these adjustments increasing the over-collection at March 31, 2002, by ($52,234). Witness Barnette testified that it was Staff's opinion that the adjusted balance at March 31, 2002, of ($1,180,602) fairly represents the

[2] Staff witness Barnette made the following adjustments to Piedmont's Deferred Cost of Gas Account No. 253.04:

(a) demand true-up computations included in the monthly filings by Piedmont were adjusted for April – July, 2001, by a total of ($59,540) to eliminate duplications of the South Carolina portion of Gaffney Demand Charges;

(b) an adjustment to Total Accrued Interest based on the actual earned overall rate of return of 8.45%, and including Staff adjustments, resulted in a credit of ($33,983), or a decrease to booked interest of ($22,651) (Piedmont booked this adjustment after the period under review.);

(c) an increase in GCRM-99 Increment/Decrement for January, 2002, by ($3,690) to reflect the correct dekatherm sales amounts;

(d) a reduction of supplier refunds for January, 2002, in the amount of $9,185 to correct the allocation of a supplier refund from Transco; and

(e) an adjustment to "Other PGA Items" for June, 2001, in the amount of $24,463 to reflect the correct dekatherms used in the calculation of a Proration Adjustment for GCRM-99 for a rate change due to cycle billing.

over-collection by Piedmont and that the amount is accurately stated and in compliance with prior Commission Orders. All of the parties accepted the adjustments proposed by the Commission Staff. Barnette, as a part of these adjustments, proposed that interest be computed at the actual earned overall rate of return of 8.45% for the twelve months ended March 31, 2001.

Brent Sires of the Commission Staff testified concerning the Utilities Department's findings and recommendations resulting from the Utilities Department's analysis of Piedmont's PGA tariff and Gas Purchasing Policies for the period of April, 2001, through March, 2002. Witness Sires testified that the Utilities Department found that Piedmont's PGA is being operated in compliance with the various Commission Orders[3]. Staff's review, according to witness Sires, indicated that Piedmont's current rate schedules include a $3.75 per dekatherm benchmark cost of gas. Further, Sires stated that Staff is not recommending any change in that current benchmark cost of gas.

Sires further stated that the Piedmont's purchased gas adjustment and industrial sales program affords Piedmont the opportunity to recover all negotiated losses from Piedmont's competitive industrial customers. As Piedmont has the opportunity to recover negotiated losses from the deferred account, Piedmont must negotiate its rates to industrial customers only to the level that is competitive with the alternate fuel prices without going below the actual cost of gas. Sires testified that his review indicated that Piedmont has been negotiating prices with the industrial customers only to the level which is competitive with the alternate fuels and not below the cost of the alternate fuels.

[3] Witness Sires specifically noted that the Utilities Department found that Piedmont's PGA was being operated in compliance with Commission Orders issued in Docket Nos. 83-126-G, 86-217-G, 95-160-G, 96-514-G, and 98-004-G.

Sires stated that Piedmont tracks oil prices on a daily basis and that Piedmont accumulates information about alternate fuels from various sources. Each month Piedmont corresponds with industrial customers regarding the cost of alternate fuels. This continuous contact with the industrial market, along with Piedmont's many years of experience in the industrial market, places Piedmont in the position of being aware and knowledgeable of the alternate fuel prices in Piedmont's service area.

In addition, Sires testified that Piedmont has a procedure to prevent itself from selling gas at a price that is below Piedmont's actual cost of gas. Under its procedure, Piedmont develops its average cost of gas on a monthly basis and then uses the monthly average price as the staring point for negotiations with competitive industrial customers. Piedmont's Gas Supply Department then evaluates rates that are being negotiated with industrial customers and compares the rates to the volumes and the average commodity price of gas each month.

Sires also opined that Piedmont is acting prudently in arranging for supplies to meet the requirements of its firm customers today, as well as in the future. According to Sires, Piedmont must meet the demands of its firm customers on a peak day, and Piedmont relies on firm contractual quantities as well as firm transportation capacity on the Transco system to meet its firm obligations. Sires testimony indicates that Piedmont must have the volumes of gas needed for that peak day for the firm class of customers without relying on interruptible supplies to serve Piedmont's firm customers on that peak day. For the winter period ending March 31, 2002, Piedmont has firm demand entitlements and peaking capabilities with Transco and other suppliers totaling 934,580 dekatherms. During the 2001-2002 winter period, Piedmont experienced a peak send out on January 3, 2002, of 741,112 dekatherms. A comparison of Piedmont's demand entitlements with suppliers and peaking capabilities totaling 934,580 dekatherms to the Design Day demand requirements of 934,288 dekatherms indicates that Piedmont has adequate firm supplies to meet the requirements of Piedmont's firm customers. Under the Firm Transportation Service rate schedule ("rate schedule FT") from Transco, Piedmont has the ability to take advantage of market responsive priced gas enabling Piedmont to minimize gas costs.

As for prudency in arranging for supplies to meet the requirements of its customers, Sires testified that Piedmont is active in purchasing gas supplies on the spot market and in making arrangements through interstate pipelines for the delivery of those supplies. Additionally, Piedmont has utilized changes taking place in the gas industry to maximize through put and load factor on its natural gas system. According to Sires, both of these actions by Piedmont reduce the overall cost of gas to Piedmont's customers. Sires opined that the spot market plays a vital role in providing LDCs, such as Piedmont, with natural gas supplies at prices competitive with alternate fuels and helps in reducing costs to high priority customers.

Sires also indicated that he has reviewed Piedmont's forecasted future demand requirements and the steps being taken by Piedmont to insure the reliability of supplies. To secure firm supplies for future demand on its system, Piedmont has taken steps ranging from negotiating with suppliers for capacity on the interstate systems to acquiring additional storage capacity to negotiating with suppliers for back-haul gas. Sires also offered that his observations of Piedmont's gas purchasing policies indicate that Piedmont is continuing its attempts to get the best terms available in its negotiations with suppliers and that Piedmont is meeting its obligation to maintain adequate supplies at just and reasonable costs to serve its customers.

Based on the record as a whole, the Commission makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. Piedmont is a local distribution gas company primarily engaged in the purchase, distribution, and sale of natural gas to more than 704,000 customers in the Piedmont region of South Carolina and North Carolina and the metropolitan area of Nashville, Tennessee.

2. Piedmont serves approximately 122,000 customers in South Carolina, and during the twelve month period ending March 31, 2002, Piedmont delivered 24,673,779 dekatherms of natural gas to its customers in South Carolina.

3. Piedmont provides natural gas service to both firm and interruptible customers in South Carolina. For the twelve month period ending March 31, 2002, Piedmont delivered approximately 14,400,000 dekatherms, or 58% of its deliveries, to firm customers in South Carolina and delivered approximately 10,300,000 dekatherms, or 42% of its deliveries, to interruptible customers in South Carolina.

4. For its gas purchases, Piedmont has and utilizes a "best cost" gas purchasing policy. Piedmont's "best cost" gas purchasing policy consists of five main components – the price of gas, the security of gas, the flexibility of the gas supply, gas

deliverability, and supplier relations – that are interrelated and weighed in developing an overall gas supply portfolio to meet the needs of Piedmont's customers.

5. During the twelve-month period ending March 31, 2002, Piedmont did not make any changes to its "best cost" gas purchasing policies. However, Piedmont did engage in additional steps to manage its gas costs, such as (1) participating in proceedings before the FERC and other regulatory agencies that could reasonably be expected to affect Piedmont's rates and services, (2) renegotiating and restructuring eligible supply and capacity contracts to take advantage of market opportunities, (3) utilizing the flexibility within supply and capacity contracts to purchase and dispatch gas, and release capacity, in the most cost effective manner, (4) promoting more efficient peak day use of natural gas and load growth from "year-round" markets, in order to improve Piedmont's load factor and reduce average unit costs, and (5) reviewing gas supply activities with Piedmont's internal Planning Committee, in order for the gas supply department to receive input and direction on its performance and planning activities.

6. At April 1, 2001, the balance of Piedmont's Deferred Cost of Gas Account No. 253.04 was a net under-collection of $5,061,057.

7. At March 31, 2002, the adjusted balance of Piedmont's Deferred Cost of Gas Account No. 253.04 was an over-collection of ($1,180,602).

8. For the period of April 1, 2001, through March 31, 2002, the Commission Staff proposed adjustments to Piedmont's Deferred Cost of Gas Account No. 253.04 with the net effect of the proposed adjustments increasing the over-collection at March 31, 2002, by ($52,234).

9. Piedmont's current rate schedules include a benchmark cost of gas of $3.75 per dekatherm.

10. Under its purchased gas adjustment and industrial sales program, Piedmont has the opportunity to recover all negotiated losses from Piedmont's competitive industrial customers.

11. Because Piedmont has the opportunity to recover all negotiated losses from Piedmont's competitive industrial customers, Piedmont must negotiate its rates to industrial customers only to the level that is competitive with the alternate fuel prices without going below the actual cost of gas.

12. To prevent Piedmont from selling gas at a price that is below Piedmont's actual cost of gas for the month, Piedmont's Gas Supply Department evaluates the rates being negotiated with industrial customers and compares the rates to the volumes and average commodity price of gas each month.

13. For the winter period ending March 31, 2002, Piedmont had firm demand entitlements and peaking capabilities with Transco and other suppliers totaling 934,580 dekatherms. Also for the winter period of 2001-2002, Piedmont had a Design Day demand of 934,288 dekatherms.

14. During the 2001-2002 winter period, Piedmont experienced a peak send out on January 3, 2002, of 741,112 dekatherms.

15. To meet its responsibility of maintaining adequate supplies, Piedmont is active in purchasing gas supplies on the spot market and in making arrangements through interstate pipelines for the delivery of those supplies, in utilizing changes in the gas

industry to maximize through put and load factor on Piedmont's natural gas system, in negotiating with suppliers for capacity on the interstate systems, in acquiring additional storage capacity, and in negotiating contracts with suppliers for back-haul gas.

CONCLUSIONS OF LAW

1. Piedmont is engaged in the natural gas distribution business within the State of South Carolina and is a public utility under the laws of the State of South Carolina (S.C. Code Ann. Section 58-5-10, et seq.) whose gas distribution operations in South Carolina are subject to the jurisdiction of this Commission.

2. For the period of April 1, 2001, through March 31, 2002, Piedmont's gas purchasing policies and practices were prudent. Piedmont maintained sufficient information about, and contact with, the market and Piedmont's own customers to properly operate under the PGA and industrial sales program. Further, Piedmont utilized its "best cost" gas purchasing policy in a manner which allowed Piedmont to maintain an overall gas supply portfolio to meet the needs of Piedmont's customers, both firm and interruptible, and which allowed Piedmont to obtain gas supplies, under both firm supply contracts and the spot market, taking advantage of market opportunities while also protecting Piedmont's required firm market needs. Finally, Piedmont has demonstrated prudent actions under its "best cost" gas purchasing policy by participating in relevant proceedings before regulatory bodies where rates could be affected and in reviewing, restructuring, and renegotiating supply contracts for the purchase, dispatch, and transportation of gas in a cost effective manner. The result of Piedmont's actions is that

Piedmont is meeting its obligation to provide and maintain adequate supplies at just and reasonable costs to serve its customers.

3. The current procedures in Piedmont's PGA result in a properly stated cost of gas recorded in compliance with Commission Orders. Further, the activity recorded in Piedmont's Deferred Cost of Gas Account No. 253.04 was properly recorded and reported to the Commission as required.

4. The five adjustments to Piedmont's Deferred Cost of Gas Account No. 253.04 proposed by the Staff and resulting in a net effect increasing the over-collection at March 31, 2002, by ($52,234) are adopted and approved. The other parties of record accepted the adjustments proposed by the Staff, and no party objected to the proposed adjustments.

5. The appropriate benchmark cost of gas is $3.75 per dekatherm. At March 31, 2002, the benchmark cost of gas included in Piedmont's rate schedules was $3.75 per dekatherm. No party challenged that benchmark cost of gas or requested that the Commission consider another benchmark cost of gas.

IT IS THEREFORE ORDERED THAT:

1. Piedmont is hereby permitted to maintain its commodity cost of gas at $3.75 per dekatherm. The setting of this benchmark cost of gas is without prejudice to Piedmont's right to further revise the benchmark in accordance with provisions of its PGA, if future conditions warrant, and is without prejudice to the parties' right to request review of the benchmark in accordance with the Commission's PGA provisions.

2. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Mignon L. Clyburn, Chairman

ATTEST:

Gary E. Walsh, Executive Director
(SEAL)